

Hawaii Tax System: GET

Tax Review Commission

Tax Research & Planning, DOTAX

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Hawaii System of Taxation

General Principles of Taxation

▶ Economic Efficiency

- Impose the smallest possible distortion on behavior (If distortion is intended, it should distort in the desired direction)

▶ Fairness

- Horizontal Equity—taxpayers with the same ability to pay have the same tax liability
- Vertical Equity—tax liability rises as ability to pay increases
- Alternative—tax liability is based on the benefits received

▶ Compliance and Administrative Burdens

- Cost imposed on private sector to comply with law. Cost government bears to collect taxes

Ability to Raise Revenue

- ▶ Short-run tax adequacy
 - Does the system produce the required revenue during the current budget period?
- ▶ Long-run tax adequacy
 - Does the system produce the required revenue over the long term?
- ▶ Stability
 - Does the system provide stable revenues over the economic cycle?

Attributes of Hawaii

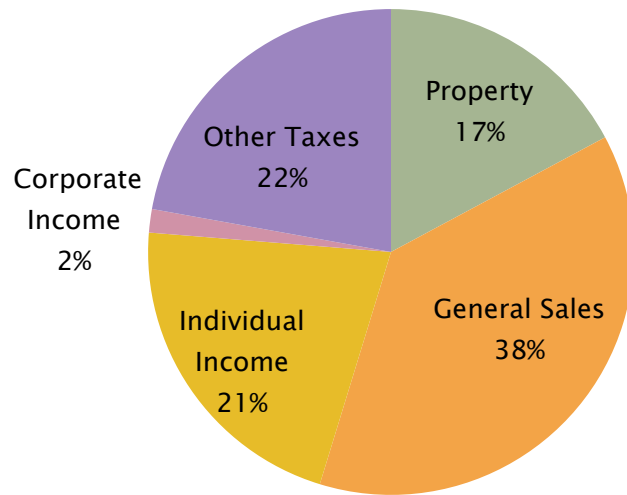
- ▶ Isolated and distant from other economies
- ▶ Exporter of services (tourism)
- ▶ Small land/ small population with narrow economic base (tourism and government)
- ▶ High cost of doing business

At a Glance: Hawaii tax system

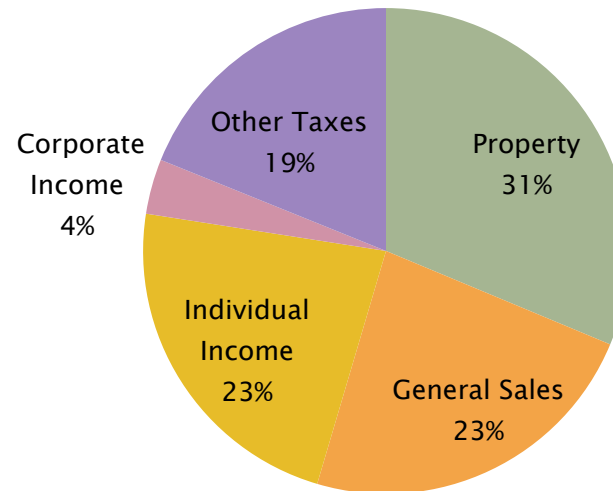
- ▶ Hawaii receives significantly more revenue from sales tax and less from property tax than most states

Composition of state and local taxes

Hawaii



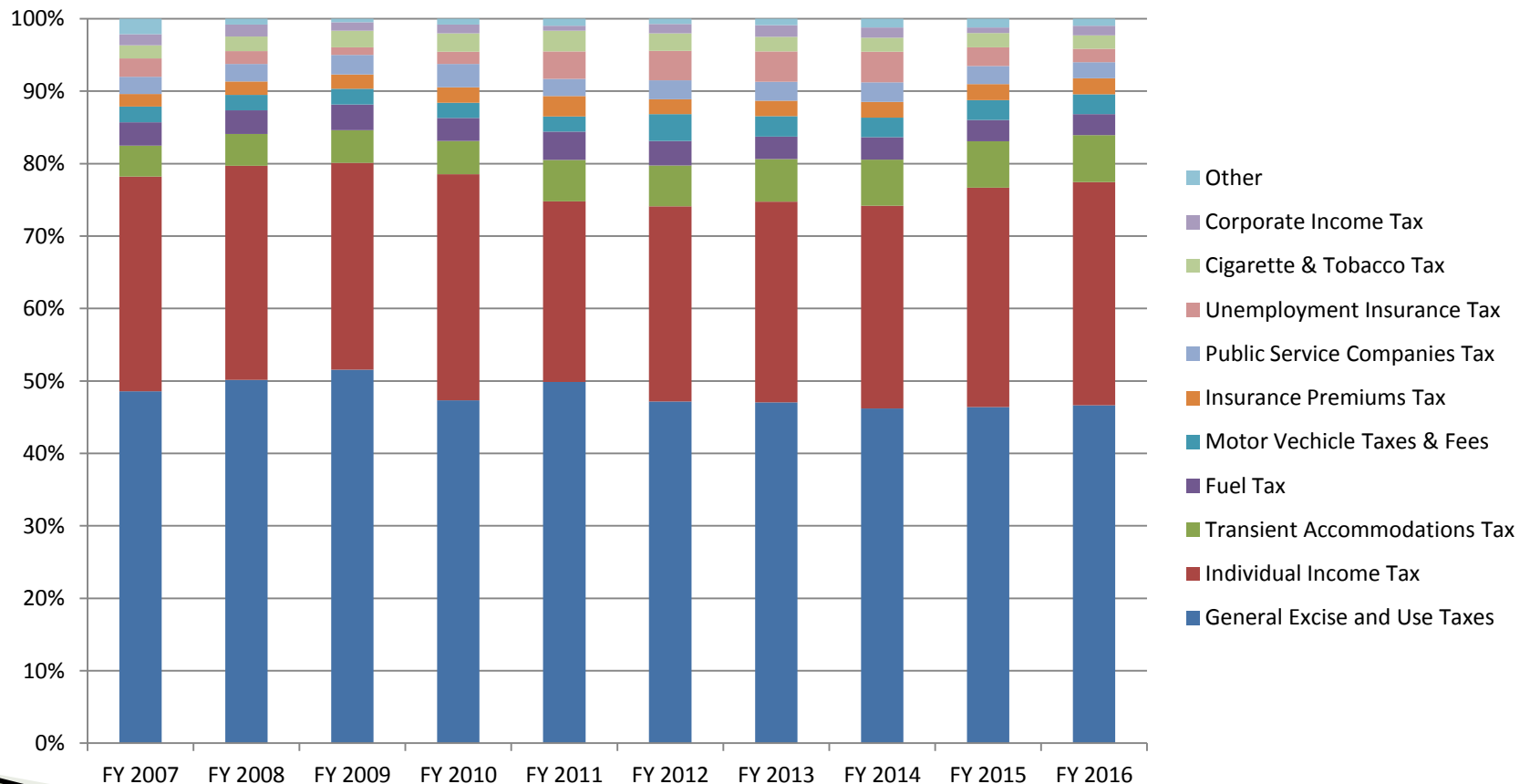
U.S. Avg



Source: Tax Foundation

GET and IIT comprise three quarters of state revenue

Composition of State Revenues



Hawaii's tax system is relatively stable and resilient over the long term

- State revenues as a percentage of Gross State Product is the same in 2016 as it was in 2007 and slightly lower as a percentage of Total Income
- State revenues were negatively affected by the Great Recession (implying less stability of tax system)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Without County Surcharge										
State Rev/GSP	8.2%	7.8%	7.2%	7.2%	7.2%	7.9%	8.4%	8.2%	8.2%	8.3%
State Rev/Total Income	11.2%	10.4%	8.9%	8.6%	8.9%	10.1%	10.7%	10.1%	10.5%	10.5%
With County Surcharge										
State Rev/GSP	8.3%	8.0%	7.4%	7.5%	7.5%	8.2%	8.7%	8.5%	8.5%	8.6%
State Rev/Total Income	11.3%	10.8%	9.2%	8.9%	9.3%	10.5%	11.0%	10.5%	10.9%	10.9%

Hawaii tax collections are highly centralized

- Hawaii collects more of its tax revenues at the state level than at the local level when compared with other states
- These rankings may overstate Hawaii's tax burden, because Hawaii may be able to export more of its taxes:
 - Federal government (income tax deduction)
 - Tourists and non-resident Military

State tax collections Per capita 2015

State	Collections per Capita	Rank
N.D.	\$ 7,583	1
Vt.	\$ 4,861	2
Hawaii	\$ 4,530	3
Minn.	\$ 4,452	4
Conn.	\$ 4,438	5
Wyo.	\$ 4,020	6
Mass.	\$ 3,976	7
N.Y.	\$ 3,952	8
Calif.	\$ 3,862	9
Del.	\$ 3,715	10
N.J.	\$ 3,524	11
Md.	\$ 3,305	12
Ark.	\$ 3,086	13
Maine	\$ 3,057	14
Ill.	\$ 3,055	15
R.I.	\$ 3,026	16
W.Va.	\$ 3,018	17
Wis.	\$ 2,949	18
Iowa	\$ 2,942	19
N.M.	\$ 2,882	20
Wash.	\$ 2,879	21
Pa.	\$ 2,821	22
Mont.	\$ 2,753	23
Mich.	\$ 2,717	24
Kans.	\$ 2,708	25
U.S.	\$ 2,694	

State-Local Tax Burden as a Share of State Income 2012

State	%	Rank	Total Tax Burden (per Capita)
N.Y.	12.7%	1	\$ 6,993
Conn.	12.6%	2	\$ 7,869
N.J.	12.2%	3	\$ 6,926
Calif.	11.0%	6	\$ 5,237
Ill.	11.0%	5	\$ 5,235
Wis.	11.0%	4	\$ 4,734
Md.	10.9%	7	\$ 5,920
Minn.	10.8%	8	\$ 5,185
R.I.	10.8%	9	\$ 4,998
D.C.	10.6%	10	\$ 7,541
Mass.	10.3%	12	\$ 5,872
Ore.	10.3%	10	\$ 4,095
Vt.	10.3%	11	\$ 4,557
Del.	10.2%	16	\$ 4,412
Hawaii	10.2%	14	\$ 4,576
Maine	10.2%	13	\$ 3,997
Pa.	10.2%	15	\$ 4,589
Ark.	10.1%	17	\$ 3,519
US	9.9%		\$ 4,420
N.C.	9.8%	20	\$ 3,659
Ohio	9.8%	19	\$ 3,924
W.Va.	9.8%	18	\$ 3,331
Utah	9.6%	21	\$ 3,556
Ind.	9.5%	22	\$ 3,585
Kans.	9.5%	23	\$ 4,131
Ky.	9.5%	24	\$ 3,298
Mich.	9.4%	25	\$ 3,631

Source: Tax Foundation

General Excise & Use Tax

General Excise and Use Tax: What is it?

- ▶ What are the General Excise and Use Taxes
 - The GET is a gross receipts tax that is imposed on the privilege of doing business in the State of Hawaii. The Use Tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales to Hawaii
- ▶ Vs Sales Tax
 - A sales tax is levied on the customer but collected by business. The GET is levied on the business
 - A sales tax is usually limited to retail sales of tangible goods whereas the GET is levied on almost all business activity
- ▶ Vs Value Added Tax (VAT)
 - A VAT only taxes the value added by business. The GET taxes the gross receipts of the business, so it taxes some business-to-business transactions

Comparison of consumption taxes

	GET	Sales	VAT
Taxpayer (statutory)	Business	Consumer	Business
Coverage	Broad	Narrow	Broad
Activity taxed	Gross receipts	Cost of taxable goods	Value-added
Inputs taxed	Yes (kind of)	No	No
Administrative Burden	Low	Medium	High

The tradeoffs of the GET

Pros	Cons
<ul style="list-style-type: none">• Low administration cost• Imposes little in the way of market distortion• Broad based tax and low rates• Hard to avoid• Exportable	<ul style="list-style-type: none">• Regressive*• Tax pyramiding *

GET raises significant revenue through a low rate and a broad base

Amongst the lowest sales tax rates in the country

State	State Tax Rate	Rank	Avg. Local Tax Rate	Combined	Rank
La.	5.00%	33	4.98%	9.98%	1
Tenn.	7.00%	2	2.46%	9.46%	2
Ark.	6.50%	9	2.80%	9.30%	3
Ala.	4.00%	40	5.01%	9.01%	4
Wash.	6.50%	9	2.42%	8.92%	5
Okla.	4.50%	37	4.36%	8.86%	6
Ill.	6.25%	13	2.39%	8.64%	7
Kans.	6.50%	9	2.12%	8.62%	8
N.Y.	4.00%	40	4.49%	8.49%	9
Calif.	7.25%	1	1.00%	8.25%	10
Hawaii	4.00%	40	0.35%	4.35%	45

Highest per capita collections of any state

State	Collections per Capita	Rank
Hawaii	\$ 2,090	1
N.D.	\$ 1,835	2
Wash.	\$ 1,746	3
Nev.	\$ 1,412	4
Wyo.	\$ 1,384	5
Tex.	\$ 1,226	6
Miss.	\$ 1,144	7
Conn.	\$ 1,137	8
S.D. (b)	\$ 1,131	9
Ind.	\$ 1,100	10
N.M. (b)	\$ 1,082	11
Fla.	\$ 1,075	12
Ark.	\$ 1,069	13
Kans.	\$ 1,049	14
Ohio	\$ 1,025	15

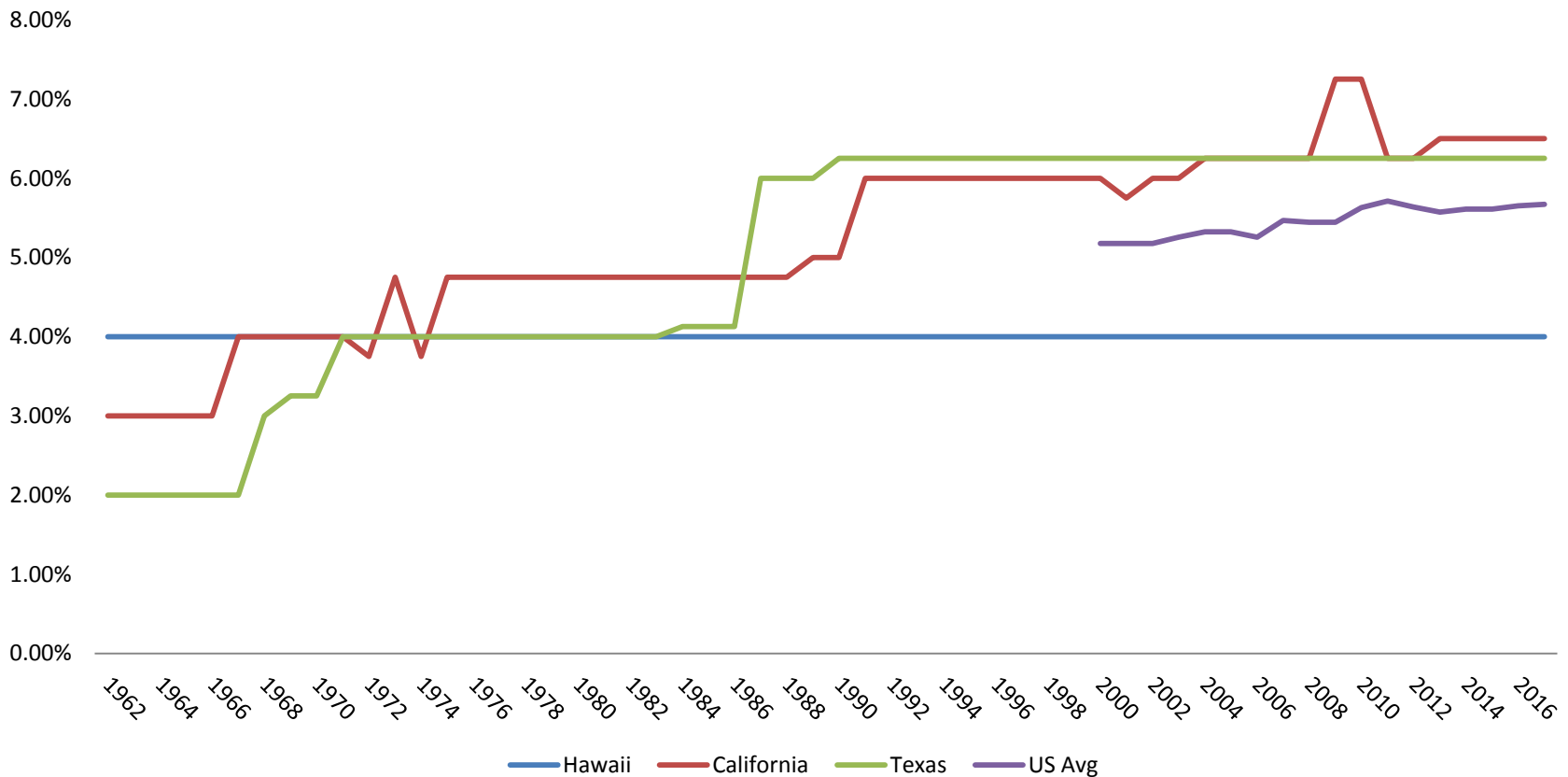
Broadest scope of sales tax of any state

State	Sales Tax Breadth	Rank
Hawaii (a)	104%	1
N.D.	73%	2
S.D. (a)	65%	3
Wyo.	62%	4
N.M. (a)	59%	5
Nev.	49%	6
Miss.	47%	7
Ark.	43%	8
Tex.	42%	9
Maine	41%	10
Ariz.	41%	11
Fla.	40%	12
Ind.	40%	13
Idaho	38%	14
Wash.	38%	15

Source: Tax Foundation

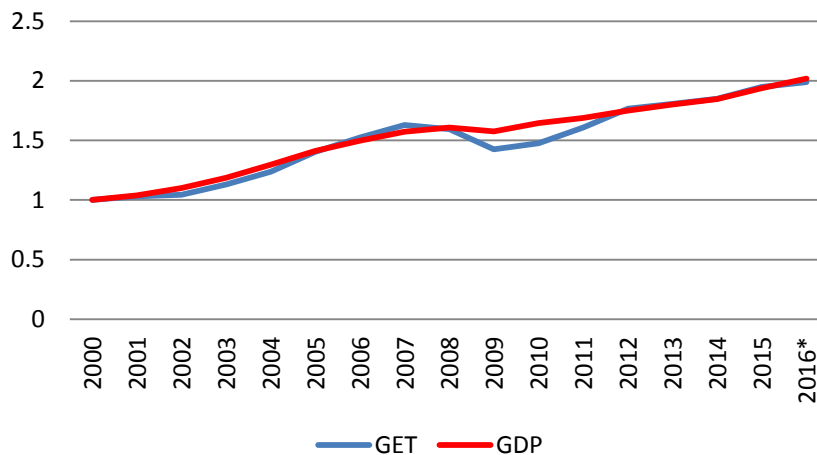
Hawaii's GET rate has been remarkably stable relative to the rates of sales taxes in other states

State Sales Tax Rates

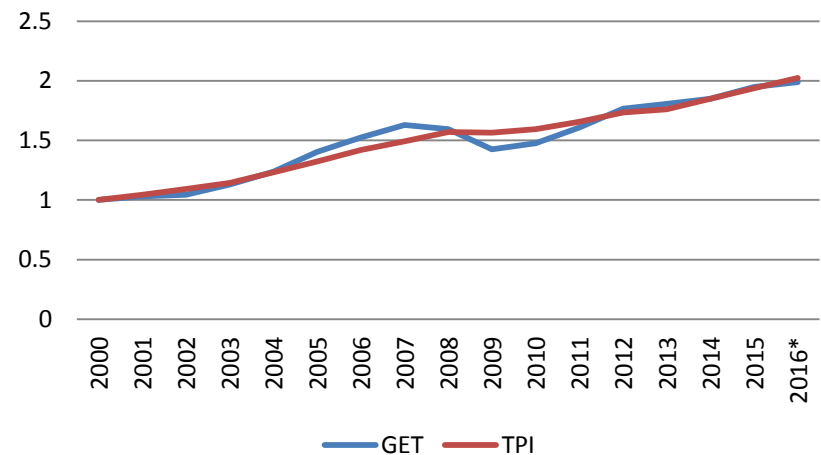


GET revenues are stable and closely correlated with economic performance

GET vs Gross State Product



GET vs Total Personal Income



GET revenue is closely correlated to GSP, but it is less correlated during periods of sharp economic downturns

What is not covered by the GET: an incomplete list

Deduction/ Exemption	Cost \$millions (2012)	Rationale
Non-profit sales (health, education)	254	Social
Health Insurance Premiums	108	Reduce pyramiding/social
Sub-contractors	96	Reduce pyramiding
Hotel operators, wages, etc	46	Reduce pyramiding
Prescription drugs and prosthetics	30	Social
Aircraft leasing	2	Reduce pyramiding
Food stamps	0	Social
Exports	Forthcoming	Not consumption

*Numbers will be updated in the final report

A sizable percentage of the GET gets exported to non-resident taxpayers

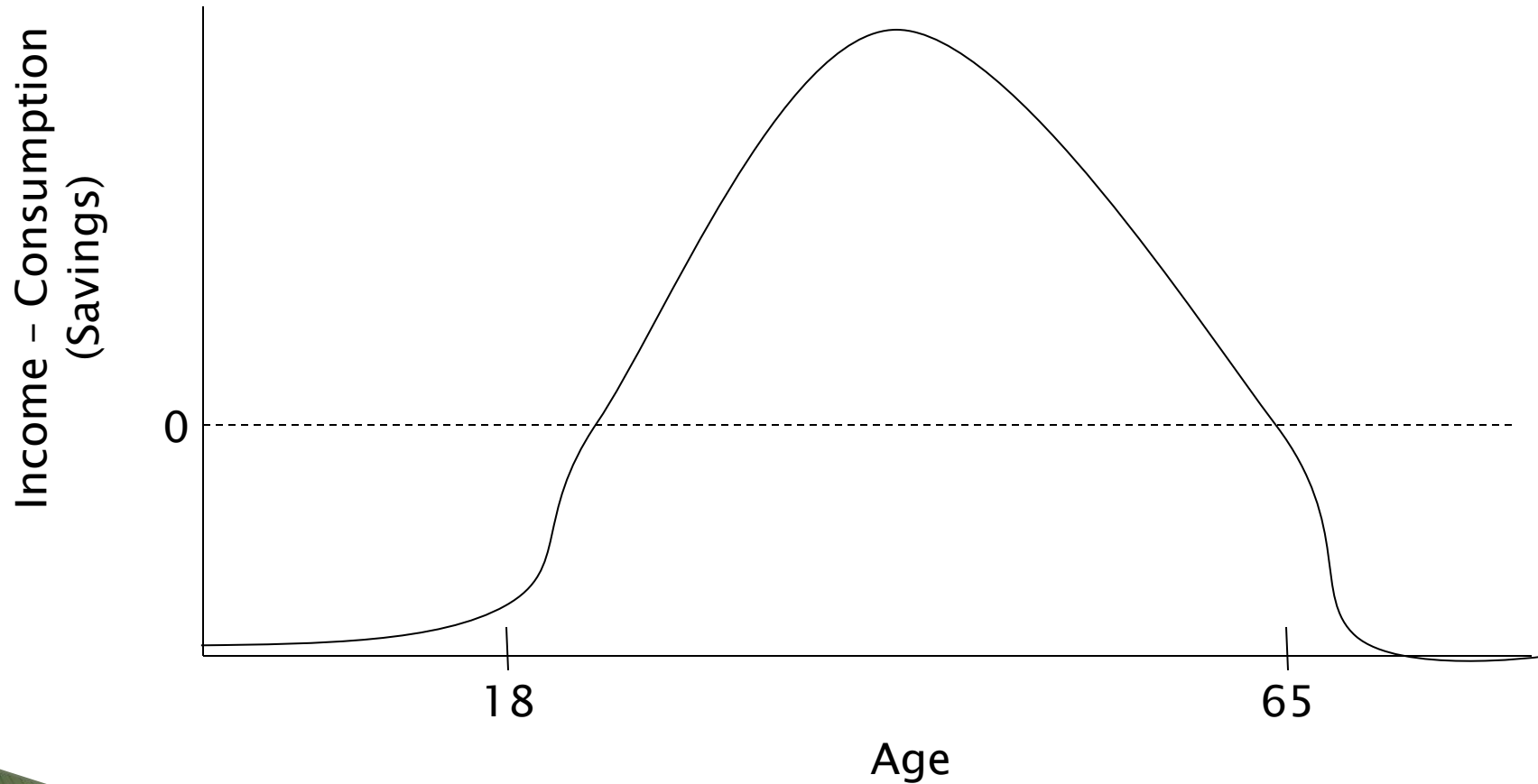
- ▶ Studies have found that between 20% and 38% of the GET tax is paid by non-residents.
 - Mainly tourists and non-resident military

Miklius et al (2003) 2003 TRC Report	32.9%
Tax Research & Planning (2006) 2007 TRC Report	37.9%
Bowen and Leung (1989)	20.0%
<u>Average</u>	<u>30.3%</u>

How regressive is the GET?

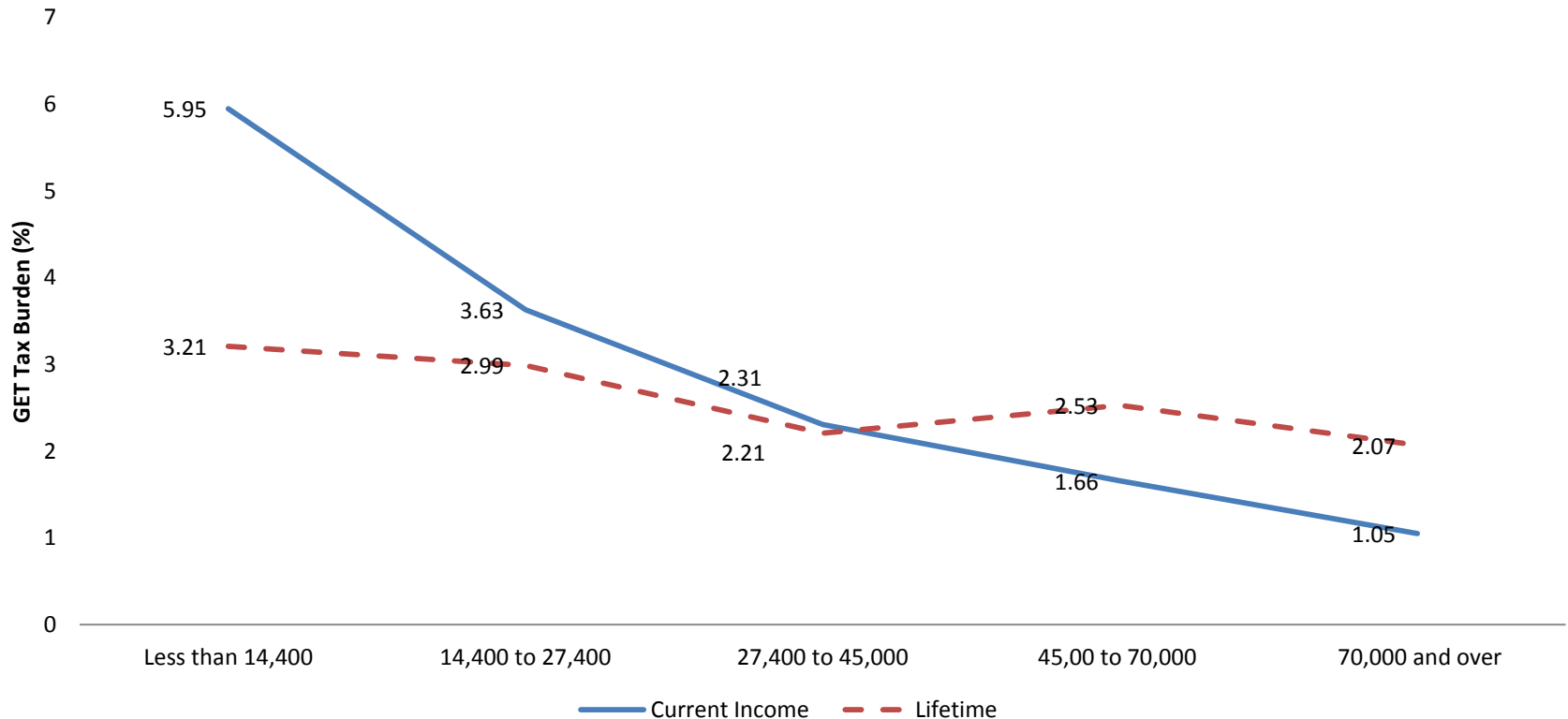
- ▶ Lower income people spend a larger portion of their income on consumption
- ▶ Studies tend to overstate the regressivity of consumption taxes because:
 - People have different consumption patterns over their lifetime
 - Elderly people and young adults (students living at home) often consume more than their income.
 - Middle aged households are saving for retirement, so they are consuming less
 - Disadvantaged populations receive benefits from the government, which do not count as income
 - EITC, food stamps, low-income rental credit, low-income food credit

Lifetime savings patterns



GET is less regressive when you account for the entire lifecycle of the taxpayer

GET Tax Burden
% of income by income bracket



Source: William Fox (2006). Hawaii's General Excise Tax: Should the Base be Changed? TRC 2005-2007

How does GET affect housing costs?

- ▶ Housing is significant portion of HH spending (especially in HI)
- ▶ More than 30.9% HHs spend more than 35% on mortgage in HI vs 22.3% in US
- ▶ More than 47.1% of HHs spend more than 35% of income on rent vs 41.4% in the US

HH Income	<50,000	50,000–100,000	100,000 +
Household income	28,491	74,730	150,763
Shelter	12,323	18,526	35,879
Shelter/Income	43.3%	24.8%	23.8%

Low income HH are more likely to rent

Low income HH are more likely to spend more of their income on housing

GET disfavors renters over owners but tax is mostly born by property owners

► Homeowners:

- The GET does not tax financial transactions (i.e. mortgage payments), so homeowners do not pay GET on shelter.
 - Regressive tax policy since higher income households are more likely to own than rent

► Renters:

- GET taxes rents which disproportionately affects low income households (since they are more likely to rent).
- HOWEVER, GET is primarily paid by property owners versus renters.
 - The housing stock is fixed in the short term, so prices are mainly driven by demand and renter's ability to pay
- THUS, assuming a partial pass through, GET is slightly regressive when it comes to housing consumption
- Additionally, low-income rental credit reduces tax burden

Exemptions/ deductions reduce tax on b2b sales and make GET more like a VAT

- ▶ Broad Tax Base
 - Hawkins (2002)--problems of cascading are less of a problem for small states with broad tax base
- ▶ Wholesale is taxed at a lower rate (0.5%)
- ▶ Exemption of exports
- ▶ Exempts taxes on insurance premiums and Public Utility Companies (But these items are subject to alternative taxes.)
- ▶ Exempts cost of subcontractors
- ▶ Refundable income tax credit for GET paid on the purchase of capital goods by businesses

Business to business taxes raise the effective tax rate but not by much

Study	Effective Rate	Comments
TRP (2007), Study on the Progressive or Regressive Nature of Hawaii's taxes	4.5%	
Brown and Ping Sun (1989)	5.3%	Does not take into account exemptions and tax credits or 1999 reforms

Small changes in the GET rate can have large impacts on revenue collections

GET headlines numbers and revenue Implications (thousands)

Rate Changes	3.5%	4.0%	4.5%	5.0%	5.5%
Rev Collection	2,820,970	3,205,733	3,590,496	3,975,260	4,360,023
Net Impact	(384,763)	0	384,763	769,526	1,154,290
% of GET	-12.0%	0.0%	12.0%	24.0%	36.0%
% of GF	-6.2%	0.0%	6.2%	12.4%	18.6%

Year 2016

Every 0.5% change roughly equates to a 6.2% change in General Fund revenues

Assessing the GET

Economic Efficiency	<ul style="list-style-type: none">• The broad base and targeted exemptions keep tax pyramiding relatively low• There is still some tax on most business to business transactions, which increases the cost of doing business• Broad scope does not favor or disfavor a particular sector (low distortions)
Fairness	<ul style="list-style-type: none">• Regressive because lower income people spend a larger percentage on taxed consumption• Less regressive if lifecycle is taken into account
Administrative Burden	<ul style="list-style-type: none">• Low compliance costs and low administrative costs by the government
Stability	<ul style="list-style-type: none">• GET revenue is closely correlated with GDP growth but falls more significantly during economic downturns

Thank You